



County of Los Angeles
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Chief Administrative Officer

January 9, 2004

To: Supervisor Don Knabe, Chairman
Supervisor Gloria Molina
Supervisor Yvonne Brathwaite Burke
Supervisor Zev Yaroslavsky
Supervisor Michael D. Antonovich

From: David E. Janssen
Chief Administrative Officer

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SACRAMENTO UPDATE -- GOVERNOR'S PROPOSED FY 2004-05 BUDGET

Today, Governor Schwarzenegger released his \$99.1 billion Proposed Budget for FY 2004-05 which his Administration claims will close a \$26 billion Budget gap from prior years as well as the Budget year. The proposal is characterized as a "workout plan for the State Budget" to avoid bankruptcy that will require three years to fully implement. It does not assume an increase in State taxes.

Two of the elements of the "workout plan" depend upon voter approval at the March primary election: a \$15 billion Economic Recovery Bond and a constitutional amendment to prohibit borrowing to balance the Budget and the creation of a Budget reserve. The Proposed Budget's plan for dealing with the \$26 billion Budget gap is the third element. The final element consists of improvements in the business/jobs climate, especially workers compensation reform, to stimulate economic growth and increase State revenue to allow for the restoration of many of the proposed Budget cuts.

The Proposed Budget reduces, but does not eliminate the structural Budget deficit – the recurring gap between State spending requirements and the revenues available – which the Legislative Analyst (LAO) estimated in November to be about \$15 billion annually through FY 2008-09. According to the Budget documents, the operating deficit would be eliminated by FY 2006-07, largely as a result of "reforms contained in the Budget (that) will produce savings that increase dramatically in subsequent years." Given the proposal's significant reliance on one-time revenues from bond proceeds and loans, as well as payment obligations such as the VLF gap loan that come due in the next few years, it remains to be seen if the structural deficit will be eliminated.

The Proposed Budget would have a major impact on the County by increasing the amount of property taxes that the County (and other local governments) would be required to shift to public schools to replace State dollars. Under the current allocation formulas that would be used, the County would lose approximately \$289 million in the Budget year. In addition, the County Library District would lose approximately \$9 million. The Budget also contains a number of proposed reductions in programs that will impact the County and the people it serves.

The Budget's key economic indicators – California personal income, consumer price index and non-farm employment – and the estimates for the three major revenue sources closely track the assumptions and projections of the Legislative Analyst's November 2003 Fiscal Outlook. The LAO will release its analysis of the Governor's Proposal in February, at which point there will be a non-partisan evaluation of the economic assumptions underlying the revenue forecast and the spending projections that determine the size of the Budget gap.

THE BUDGET GAP

The \$26 billion gap includes deficits from three fiscal years: \$9.2 billion from FY 2002-03, \$3 billion from FY 2003-04 and \$14 billion from the Budget year.

THE BUDGET SOLUTION

To cover the prior year deficits, the Proposed Budget assumes the use of approximately \$11 billion in proceeds from the sale of the Economic Recovery Bonds, as well as \$4.4 billion in Budget reductions. Some \$2.3 billion was included in the proposed December mid-year reductions that the Legislature did not adopt. Another \$900 million will result from delaying payment of funding to schools owed from prior years.

The Governor proposes to close the \$14.3 billion Budget year gap as follows:

- 32 percent (\$4.6 billion) through cuts and savings;
- 21 percent (\$3 billion) from Economic Recovery Bond proceeds:
- 13.3 percent (\$1.9 billion) from delaying Proposition 98 payments to K-14 education;
- 8.4 percent (\$1.2 billion) from debt service savings;
- 7 percent (\$1.0 billion) from fund shifts;
- 6.6 percent (\$949 million) from renegotiating a less costly pension plan for new State employees;

- 6.6 percent (\$947 million) from suspending the Proposition 42 transfer of sales tax revenue for transportation projects;
- 3.3 percent (\$475 million) from transfers and other revenues, including a yet to be negotiated \$500 million revenue sharing agreement involving Indian gaming.

An estimated \$1.7 billion of Economic Recovery Bonds would not be sold at this time but could be used in FY 2005-06 to finance part of the deferred obligations that come due that year. (Presumably they could be sold now and the proceeds used to reduce the amount of required Budget cuts.) The Budget reserve is \$635 million.

IMPACT ON COUNTIES

In addition to numerous specific reductions to counties included in the roughly \$5 billion of State Budget cuts across three fiscal years, two proposals significantly impact local governments, particularly counties. The first is the \$1.3 billion increase in the amount of property taxes local governments will be required to shift to schools in order to reduce the State's obligation. Counties would contribute 76 percent of that amount. Los Angeles County would contribute 24 percent of the total or approximately \$289 million. The Administration seems to believe that local governments can absorb a \$1.3 billion property tax shift because they absorbed an equivalent loss in the current year due to the VLF gap loan. However, this ignores the fact that many local governments used one-time revenue that is no longer available to absorb the new cut.

The second is the continued deferral of local government reimbursement for State mandates, effectively a loan of approximately \$750 million to the State. The County's share of that loan could be as much as \$60 million on top of the roughly \$100 million from prior years.

BUDGET HIGHLIGHTS

Based on a preliminary analysis of the "Governor's Budget Highlights," the following proposals are most likely to impact or be of interest to the County.

General Government

SB 90 State Mandated Local Programs. In addition to continuing the deferral of local government reimbursement, the Administration plans to pursue legislation to tighten-up and limit the total amount of future reimbursements.

Public Libraries. Assistance to libraries statewide is maintained at this year's level of approximately \$160 million.

Federal Child Support Penalty. Proposes to continue and make permanent the assessment on counties of 25 percent of the cost of the Federal penalty - \$220 million - imposed because the State's automated system continues to be out of compliance with Federal requirements. The County's share will be around \$11 million. The State system is not expected to be fully automated until FY 2008-09.

Property Tax Grant Program. Proposes full funding which could provide up to \$13.5 million for the County.

Health

DSH Administration Fee. Maintains the current \$85 million fee.

Bioterrorism Prevention. Includes \$108.9 million in Federal funds to enhance the public health system's preparedness and response to bioterrorism, and other public health threats and emergencies.

Children's Medical Services. Decreases funding for Children's Medical Services Programs (CMS) local assistance funding by \$40.7 million, for a total of \$198.6 million. CMS programs include California Children's Services, Genetically Handicapped Persons Program, and Child Health and Disability Prevention, which provide medical services, case management, and therapy to those with extraordinary medical needs who are not eligible for Medi-Cal. Caps enrollment in the Genetically Handicapped Persons Program and California Children's Services, establishing a waiting list when enrollment exceeds the proposed caps. As enrolled clients leave the programs, waiting list clients will be served.

Proposition 99. Estimates Proposition 99 revenues are \$36.5 million below the 2003 Budget Act level, or \$323.1 million. Proposed decreases include \$1.7 million in the California Healthcare for Indigents Program and \$3.2 million in DHS Health Education funds.

HIV/AIDS Treatment and Prevention. Includes \$323.4 million for the Office of AIDS Treatment and Prevention Program, a decrease of \$6.6 million below the 2003 Budget Act. Almost half (\$232.3 million) is in the AIDS Drug Assistance Program which provides assistance to those infected with HIV/AIDS to purchase drugs necessary to manage the disease.

Medi-Cal Reform. Proposes major programmatic restructuring to require State DHS to seek a Federal Medicaid Demonstration Waiver. Potential reform strategies may include simplification, a multi-tiered benefit structure for mandatory and optional beneficiaries, co-payments, elimination of some services exceeding standard private health insurance benefit packages, and expansion of managed care to cover the aged

blind and disabled. The Administration estimates \$400 million in savings through a reform expected to begin in FY 2005-06.

Medi-Cal Anti-Fraud and Audit. Proposes to expand Medi-Cal anti-fraud and audit efforts including enhanced Medi-Cal estate recoveries and increased long-term care insurance purchases, expanded hospital billing audits, confirming receipt of services or products by beneficiaries, use of counterfeit-proof prescription pads, and delaying issuance of Medi-Cal checks by one week to allow investigation of potentially fraudulent claims before checks are issued. These actions are intended to save over \$200 million in a combination of one time and ongoing measures.

Medi-Cal Managed Care. Assesses a voluntary 6% Access Quality Improvement Fee on Medi-Cal managed care plans to leverage additional Federal matching funds and to reduce General Fund spending by \$75 million.

Medi-Cal County Administration Costs. Implements plan to control county welfare department allocations for Medi-Cal eligibility determinations. The control plan would be submitted to county welfare departments by January 2005, including productivity standards and overall performance standards. Trailer bill language will be proposed to restrict county wage increases to specified cost-of-living adjustments to reduce disparities among counties. This is expected to save \$10 million in the Budget year, and increase to \$20 million in subsequent years.

Adult Day Health Care Reform. Implements a one-year moratorium on new Adult Day Health Care (ADHC) centers and a moratorium on certification for increased capacity of existing ADHC centers. Removes therapy and transportation from the bundled ADHC reimbursement rate, allowing ADHC centers to bill for these services separately. This is expected to save \$25.4 million.

Federally Qualified Health Centers and Rural Health Clinics. Proposes to seek Federal authority through a State Plan Amendment to eliminate an alternative rate methodology for enhanced reimbursements from Medicare and Medi-Cal, and to recalculate and set rates prospectively using the average of 1999 and 2000 cost reports and base the rates on audited or reconciled cost information. This is expected to save \$32.2 million.

Healthy Families Program. Proposes to cap enrollment at the January 1, 2004 level and implements a two-tiered benefit package, including higher premiums for the more comprehensive package. This program is expected to serve 737,000 children in FY 2004-05.

Alcohol and Drug Programs. Includes \$597.8 million, an increase of \$5.1 million above the FY 2003-04 level, for substance abuse prevention programs and \$3.1 million

for Drug Medi-Cal treatment services which include perinatal treatment, narcotic treatment, and outpatient drug free therapy.

Office of Statewide Health Planning and Development. Increases funding by \$5.4 million to provide sufficient staffing to review hospital construction plans. Continues funding for scholarships and loan repayment for health care professionals in medically underserved areas, including increases of \$650,000 for the Registered Nurse Education Fund, \$206,000 for the Mental Health Practitioner Education Fund, and \$131,000 for the Vocational Nurse Education Fund.

Mental Health

Mental Health Program Funding. Includes \$2.5 billion, an increase of \$373.4 million above the FY 2003-04 level.

Early Periodic Screening, Diagnosis, and Treatment Program (EPSDT). Includes \$787 million to provide EPSDT services and proposes cost control measures such as ensuring that rates reflect actual costs, implementing oversight activities to monitor expenditures, and seeking Federal Flexibility to reform the program so that beneficiaries' needs are met at costs that are affordable to the State.

Children's System of Care Program. Eliminates \$20 million from the General Fund because the 170,000 children served under the Children's System of Care Program will receive medical services through the EPSDT program, making the Children's System of Care Program no longer necessary.

Mental Health Managed Care. Provides a \$10 million increase to reflect increased caseload.

Integrated Services for the Homeless. Provides \$54.9 million to continue services to the homeless mentally ill.

Social Services

CalWORKs Employment Services. Provides an augmentation of \$191.9 million for employment services.

CalWORKs Grants. Proposes a 5 percent reduction in CalWORKs grants to save \$178 million. An additional \$26.4 million would be saved by tightening work participation requirements and reducing grants for noncompliant participants and participants reaching time-limits.

CalWORKs Cost-of-Living-Adjustment (COLA). Proposes to save \$98.5 million by suspending the July 2004 grant COLA.

Child Care. Proposes to significantly reform child care by lowering the reimbursement rates for certain providers, eliminating child care services to 11 and 12 year olds, eliminating child care services to 13 year-old children whose family income is above 75 percent of the Statewide Median Income (SMI), and imposing a sliding scale fee for subsidized care (capped at 10 percent of family income) when the family income is at 40 percent of the SMI. The estimated savings for these reforms is \$33.4 million for Stage 1 and \$62.5 million for Stage 2 for total savings of \$95.9 million.

Temporary Assistance for Needy Families (TANF). Proposes a reserve of \$158.4 million for unanticipated needs, including Federal reauthorization of the program.

Foster Care. Proposes program reforms to promote the care of more children in a family home environment and to shorten the period of time children spend in foster care and group homes. The specifics will be included in the May Revision but may include establishing performance based contracts, restructuring foster care rates and pursuing a Federal flexible funding waiver to allow foster care funds to be used for preventive services.

In-Home Supportive Services. Proposes \$899.4 million for the program, which represents a 29.4 percent reduction, and proposes to reduce the State's contribution for wages and benefits to the State minimum wage. The current rate is \$10.10 per hour. The reduction would be phased in as contracts expire. Also proposes to eliminate domestic and related services for recipients who live with family members. The Administration will submit a quality assurance proposal in the Spring.

Immigrant Programs. Proposes to restructure and consolidate State-funded immigrant programs into a single block grant to counties for a savings of \$6.6 million. The programs are: CalWORKs Benefits for Recent Documented Immigrants, California Food Assistance Program, Cash Assistance Program for Immigrants, and the Healthy Families Program for Documented Immigrants.

Los Angeles Eligibility, Automated Determination, Evaluation and Reporting (LEADER) System. Includes \$15.6 million for maintenance and operation of the LEADER System, which represents a \$1.6 million increase.

Statewide Fingerprint Imaging System. Proposes \$8.5 million for maintenance and operation, a \$2.3 million reduction in the current year and \$2.2 million in the Budget year to reflect a more efficient computer network.

County Share of Child Support Collections. Proposes to eliminate the county share of child support collections in lieu of further reductions to the Child Support Program.

Resources and Environmental Protection

Natural Resources. Increases State Park fees to raise \$18 million to offset General Fund reductions. Funding for the Department of Fish and Game is reduced \$1.8 million for stream clearance and restoration activities, and increased by \$1.2 million for implementation of the Marine Invasive Species Act. Appropriation of funds from Propositions 40 and 50 will be deferred while the Administration explores ways to reorganize and streamline resource conservation efforts.

Environmental Protection. Decreases appropriations for the Air Resources Board by \$35 million, largely due to expiration of \$29.6 million in one-time grant funding. However, \$3 million will continue measurement and monitoring equipment upgrades, and \$1.5 million will be used for the new Non Toxic Dry Cleaning Incentive Grant Program. Water Resources Control Board appropriations are reduced \$10 million, impacting implementation of statewide septic tank standards, water quality management and planning, and investigation of emerging pollutants, including Chromium 6. The Integrated Waste Management Board will use \$52.3 million from the Electronic Waste Recovery and Recycling Account for implementation of the Electronic Waste Recycling Program to reduce the huge stockpile of electronic devices, such as computer monitors and televisions.

Justice and Public Safety

TANF. Funds the Probation portion for the first three months of FY 2004-05 and eliminates all funding as of October 2004 which would result in a loss of \$55 million to the County Probation Department in FY 2004-05 and \$83 million in the following year.

State Correctional Fees. Decreases General Fund support by \$1.9 million to be replaced by revenue from a new local fee-for-service program.

COPS. Maintains the \$100 million current year level.

Juvenile Crime Prevention Act. Maintains the \$100 million current year level.

Booking Fees. Eliminates the \$38.2 million reimbursement to cities for booking fees paid to counties. Trailer bill language will be proposed to eliminate the authority of counties to charge cities and special districts.

High Technology Grants. Discontinues funding.

Standards and Training for Corrections. Provides no funding for reimbursement by the Board of Corrections.

Peace Officers Standards and Training. Maintains training reimbursement at current level of \$25.5 million.

Transportation

State Transportation Improvement Program. Proposes to reschedule \$2.6 billion in projects into subsequent fiscal years resulting in the loss of \$30.5 million to the County in FY 2004-05.

Prop 42. Suspends transfer of \$1.127 billion, including \$179.5 to local governments which will result in a loss of \$18 million to the County for repaving of streets in unincorporated areas in FY 2004-05.

Judicial

Trial Court Funding. Proposes to restructure court security to allow courts greater cost control and flexibility. Employee benefit and collective bargaining process would be changed to include State level participation.

We will continue to keep you advised.

DEJ:GK
MAL:JR/JF:hg/n

c: Executive Officer, Board of Supervisors
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